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CHARTERED ACCOUNTANTS

GST IMPLICATIONS ON DEVELOPMENT OF PLOTS

Contributed by CA Sri Harsha and CA Manindar

Introduction:

Development agreements are popular not only with respect to the construction of residential or commercial complexes but also with respect to laying and development of plots. The real estate companies enter into agreements with landowners for the purpose of laying of plots and undertaking various development works viz. compound wall, approach roads, parks, plantation, street lighting, drainage/sewerage facilities etc. In consideration for undertaking these activities, the developer is generally entitled to a portion of the developed plots. The landowner is entitled to sell the remaining portion of the developed plots. Let us understand the GST[1]implications in connection with these arrangements. Typically, every joint development agreement gives raise to four transactions for which the tax impact has to be understood:

Transaction I - Transfer of Development Rights (TDR) by landowner to developer
Transaction II - Construction Services provided by developer to landowner
Transaction III - Sale of Plots allotted to his share by developer
Transaction IV - Sale of Plots allotted to his shared by landowner

In this article, transactions between the developer and landowner are analyzed. In the upcoming journal, the transactions between the developer and his customers and landowner and his customers along with concluding remarks shall be discussed.

Further, even though all these transactions arise by a virtue of a single agreement, the same cannot be called as composite supply, since the aspect of composite supply comes into play when there are multiple taxable supplies provided to a single recipient. Since, in the instant case, the supplier and recipient for each supply vary, the tax treatment qua each transaction has to be examined.

Transfer of Development Rights by landowner to developer:
(Transaction – I)

The supply of TDR to developer for allowing the latter to enter and develop the land would amount to supply of service. Entry 41A of Notification No 12/2017 – CT (R) provides exemption for services by way of TDR on or after 1st April 2019 ***for construction of residential apartments*** subject to certain conditions. The phrase 'residential apartment' is defined vide Explanation to Notification No 11/17 – CT (R) at entry

[1]Goods and Services Tax

(xxix) to mean apartment intended for residential use as declared to RERA[2] or competent authority. Further, the word 'apartment' is defined vide Explanation 3(v) to Notification No 12/2017 – CT (R) by making a reference to section 2(e) of RERA laws[3], which does not include plot in its ambit.

Hence, on a reading of the exemption entry and definition of 'apartment' it is evident that the TDR for development of plots is not covered under the exemption entry and accordingly taxable. Even assuming that plots are covered under the ambit of 'residential apartment', on a reasoning that the plots will be ultimately used for residential apartment, it would be hard to satisfy the exemption entry since the exemption is carved out for ***construction*** of residential apartments and not for services which eventually result in construction of residential apartments. Hence, it would be hard to claim exemption for transfer of development rights for the layout and development plots. However, it is important to look at the judicial development in the matter of Nirman Estate Developers Private Limited[4] before Bombay High Court, where taxation of TDR is currently under challenge before taking a final call to pay tax or not by the landowners. The plea of tax payer in that matter was that TDR is a benefit arising from land, the same shall be treated as immovable property and accordingly no tax is required to be paid when such immovable property is transferred to developer for layout of plots.

Construction Services provided by Developer:
(Transaction – II)

Schedule III of the CT Act[5] provides for a list of transactions which are neither supply of goods nor supply of services. Transaction by way of sale of land is covered under entry 5 of schedule III of the CT Act which implies that the sale of land is excluded from the meaning and scope of supply. However, in case of development of plots, the developer is undertaking the obligation of laying of plots and development of various amenities. In consideration of this, the developer is entitled to a portion of the developed plots. Therefore, the transaction between developer and landowner towards laying of plots are concerned, does not fall under the ambit of sale of land in order to get covered under schedule III.

The issue, whether the development of plots to landowner amounts to supply or not has been examined recently in the ruling of M/s Maarq Spaces Private Limited[6]. The facts involved in this case are that the applicant has entered into an agreement for the development of land into the residential layout of plots along with amenities. The consideration was agreed by way of share of revenue received towards the sale of plots. It has been agreed to share the revenue in the ratio of 75% for the landowner and 25% for the developer.

In this context, the applicant pleaded that the activity of development work carried out in respect of the land is an activity incidental to the sale of land and are not liable to pay any tax. The AAR has considered the submissions of the applicant and rejected their plea. It was held that the activity of development of

[2]Real Estate Regulatory Authority – A body constituted under Real Estate (Regulation & Development) Act, 2016
[3]Real Estate (Regulation & Development) Act, 2016
[4]2018 (12) TMI 1442 – Bombay High Court
[5]Central Goods & Services Tax Act, 2017
[6] 2019 (11) TMI 994

plots is not covered under schedule III, it amounts to supply of service and is subject to tax. The observations made by AAR are as under:

9.6 In Para 6 it is provided that the entire cost of development shall be borne by the applicant. This shows that the applicant is engaged in the activity of providing a certain service to the landowners and the landowners will compensate the applicant for the same in accordance with the terms of the agreement.

9.7 The revenue sharing arrangement in Para 8 of the agreement indicates that the applicant gets an amount on the sale of each individual plot. This shows that there are no fixed earmarked plots to which the applicant can claim an entitlement. Further the amount received on the sale of the plots is credited to an escrow account and then only the same is divided. This further shows that the applicant is not the owner of the plots and consequently cannot claim sale of the plots as his supply.

9.10 On the basis of the aforementioned provisions of the agreement it would be in order to conclude that activities undertaken by the applicant are not qualified to be covered under entry number 5 of Schedule III of the said Act. Thus, the activities undertaken by the applicant amount to a supply of service and we answer the first question in the affirmative, i.e. the activities undertaken by the applicant, as envisaged in the agreement placed before the Authority, amount to a supply of service to the landowners and is liable to be taxed appropriately under the provisions of the CGST/KSGST Acts"

Hence, the services provided by the developer to the landowner would not be classified as Entry 5 of Schedule III and would be treated as supply of services.

Rate of Tax:

Particulars	Rate of Tax
Transaction 1	Since the transfer of development right to the developer for development of land into saleable plots would amount to supply of service, and no specific entry is available under Notification No 11/17 – CT (R), the tax rate shall be as per Entry 35 (residual entry) which is fixed at 18%.
Transaction 2	As development works amounts to the supply of service, let us now proceed to understand the rate of tax to be applied. Though plot development activities also come within the meaning of real estate projects under RERA laws[7], the rate of tax at 5%/1% was limited to real estate projects involving the construction of apartments. Therefore, the activity of plot development would come under the ambit of residuary entry i.e. Entry 3(xii) of Notification No 11/2017-CT(R) and is subject to tax at the rate of 18%.

Value of Supply:

[7]Real Estate (Regulation & Development) Act, 2016

The value of taxable supply shall be the transaction value, which is the price actually paid or payable for the services where the supplier and recipient of supply are not related, and the price is the sole consideration for the supply. However, in the instant case, the 'price' is never negotiated between the land owner and developer. The developer is entitled for the land which is embedded in the developed plot as consideration for the services and the landowner is entitled for developed plots as consideration. Since there is no 'price', the valuation based on transaction value gets failed and resort has to be made to arrive value as per rules.

In cases where consideration for a supply is wholly or partly in non-monetary form, then the value of supply shall be determined in terms of Rule 27 of the CT Rules. Thus, in terms of the referred rule, the value of supply shall be determined with reference to the open market value of such supply.

For this purpose, the term 'open market value' has been defined to mean the full value in money, excluding the integrated tax, central tax, State tax, Union territory tax and the cess payable by a person in a transaction, where the supplier and the recipient of the supply are not related and the price is the sole consideration, to obtain such supply at the same time when the supply being valued is made.

In the case where the value of supply cannot be determined with reference to open market value or money equivalent value of the consideration received in non-monetary form, then the value of supply shall be required to be determined with reference to the value of supply of like kind and quality.

The term 'value of supply of goods or services of like kind and quality' is defined to mean any other supply of goods or services made under similar circumstances that, in respect of the characteristics, quality, quantity, functional components, materials, and the reputation of the goods or services or both first mentioned, is the same as, or closely or substantially resembles, that supply of goods or services or both.

In cases where it is not practicable to determine the value with reference to the above methods, then the value shall be determined by applying Rule 30 and Rule 31. In terms of Rule 30, the value shall be 110% of the cost of provision of such services.

Rule 31 provides that where the value of supply of goods or services cannot be determined under Rule 27 to 30, the same shall be determined using reasonable means consistent with the principles and the general provisions of section 15 and the provisions of this Chapter. It also provides that in case of supply of services, the supplier may ignore Rule 30 i.e. determination of value based on the cost of provision of service and opt for determination based on reasonable means under Rule 31.

Now, let us proceed to value the supplies namely Transaction 1 and Transaction 2 as under:

Particulars	Value of Supply
Transaction 1	In view of the above definition given for 'open market value', it is nothing but the value in money payable by the unrelated buyer to landowner to obtain such supply at the same time when the supply is being valued is made. This is not possible, since TDRs will never be sold for full value in money to any buyer. Hence, open market value fails and then resort has to be made to alternative method as stated above, which is 'value of supply of goods or services of like kind and quality'. Further, this method is not practicable for a transaction in the nature of TDR. In view of the above discussion, the value of TDR can be arrived by adopting the methodology prescribed in Rule 30 or Rule 31. Since, it is hard to obtain the cost of provision of services involved in supply of TDRs, it is safe to adopt valuation as per Rule 31, by taking the market value of land transferred to the developer as value of TDRs. Alternatively, the value of plot sold by developer to his unrelated buyer near to the development agreement can also be taken as value of TDRs, as suggested for the valuation of TDRs involved for construction of residential apartments.
Transaction 2	In view of the above definition given for 'open market value', it is nothing but the value in money payable by the unrelated buyer to developer to obtain such supply at the same time when the supply being valued is made. If the developer is selling his share of plots to unrelated buyer, the same shall be the open market value and accordingly value of services provided to land owners can be arrived at. If the developer is not selling any of his plots to unrelated buyer, then valuation based on open market value is not possible and hence another alternative as prescribed in Rule 27 shall be opted. It is very difficult to obtain a development work which is similar in commercial circumstances to that of the development work undertaken by a particular developer. Therefore, it is very difficult to identify a similar supply to determine the value of supply of like kind and quality and not practicable to determine the value of like kind of supply. In view of the above discussion, the value of development services undertaken by the developer shall be determined with reference to Rule 27 (open market value) or Rule 30 or Rule 31, whichever is available. As stated above, if the developer sells the plots to an unrelated buyer, then Rule 27 can be opted. If the developer is not selling, then he may choose 110% of cost of construction pertaining to the land owner's share shall be taken. If the developer is of the belief that the margin would not be to the tune of 10%, then he may choose to maintain books of accounts to indicate the appropriate margin to pay tax on such value as per Rule 31. The least litigative way would be Rule 27 or Rule 30.

Time of supply:

Coming to the aspect of time of supply, since the activity of plot development is a supply of service, relevant sections has to be seen and accordingly the time of supply shall be determined with reference to section 13 of the CT Act. Accordingly, the time of supply for services shall be determined to be earlier of the following:

- If invoice issued is by supplier within prescribed period - the date of issue of invoice or date of receipt of payment, whichever is earlier or
- If invoices is not issued by supplier within the prescribed period - the date of provision of service or the date of receipt of payment, whichever is earlier; or
- the date on which the recipient shows the receipt of services in his books of account, in a case where time of supply cannot be determined qua above provisions

The time by which an invoice has to be issued is dealt by Section 31. The registered person supplying taxable services, shall, before or after the provision of service but within a period of 30 days shall issue a tax invoice[8].

Hence, from the above, it is evident that, there is no specific provision which deals with time of supply when non-monetary consideration is received. Further, the residuary clause, which states that the date when the recipient shows receipt of services in his books of accounts would also not be of great help, since the land owner does not generally maintain books of accounts and even if assumed that the same are maintained, there will be no entry stating that the services are received from the developer. It would be only a change in assets from land to allotted plots to his share. Hence, the residuary clause would not be of great help to the services provided by the developer.

Further, Section 13(5) states that if the time of supply cannot be determined under the normal provisions of said section, then, time of supply shall:

- in a case where a periodical return has to be filed, the date on which such return is to be filed
- in any other case, be the date on which the tax is paid

By adopting the residuary provision, it can be argued that when the developer pays tax on construction services provided by him to land owner, then that would be the date, on which time of supply would arise. Ideally, the time of supply has to be identified for making payment of tax, whereas the residual entry would state that the date of payment of tax is the time of supply. Hence, reliance on the residuary clause is also not advisable.

The above problem of fixing of time of supply for services provided arises only in case of non-monetary consideration, since there is no specific section to deal with time of supply in the instances of non-monetary consideration. However, for the purposes of valuation, it is evident that non-monetary

[8]The provisions dealing with continuous supply of service does not apply here since there are no periodic payment obligations from the land owner so that the contract fits into the definition of 'continuous supply of service' as per section 2(33) of CT Act.

consideration has to be included. Hence, on a reading of the valuation provisions and in absence of any specific provision for time of supply in the instance of non-monetary consideration, it can be argued that the payment above should also include non-monetary consideration. The phrase 'date of receipt of payment' as available in section 13 as explanation can be only seen as dealing with monetary consideration and not for non-monetary consideration.

Hence, let us continue to examine the time of supply based on view that phrase 'payment' used in section 13(2) covers monetary and non-monetary and monetary alone.

Particulars	**Time of Supply**
Transaction 1	If the phrase 'payment' is to be interpreted that the same covers non-monetary instances also, then the time of supply shall be the date of receipt of plots allotted to land owner by the developer, which would be ideally at the end of the completion of project. If the phrase 'payment' is to be interpreted that the same does not cover non-monetary instances, then the time of supply has to be arrived based on the rationale behind Notification No 4/2018 – CT (R), wherein the time of supply is fixed when developer transfers possession or right in constructed complex, building or civil structure to the land owner by entering into a conveyance deed or similar instrument (for example allotment letter). Even though the said notification does not deal with plots and is not applicable for joint development agreements entered post April 2019, the logic can be picked up, since the said notification deals with time of supply of similar services. Hence, the time of supply may be taken as when the developer enters into a conveyance deed or similar instrument to transfer possession in plots to the land owner, which may arise at the time of completion of the project. Hence, time of supply can be fixed at the time of completion of the project.
Transaction 2	If the phrase 'payment' is to be interpreted that the same covers non-monetary instances also, then the time of supply shall be the date of receipt of land for development into plots, since the date of receipt is earlier than the date of issuance of invoice, irrespective of the fact that the invoice is issued within the prescribed period or not. As stated above, the essence of time of supply is to find out when the tax has to be paid. If the date of receipt of land for development is considered as payment for developing of plots for landowners, then the tax has to be paid by next month. However, as stated above, the valuation has to be based on open market value or cost of construction, which would not be available as on the date of receipt of land from landowner. Hence, it would not be possible to arrive the value on the date of receipt of land by developer. Hence, even assuming that the 'payment' includes non-monetary consideration, the valuation fails on such date. If the phrase 'payment' is to be interpreted that the same does not cover non-monetary instances, then the time of supply has to be arrived based on the rationale behind

	Notification No 4/2018 – CT (R), wherein the time of supply is fixed when developer transfers possession or right in constructed complex, building or civil structure to the land owner by entering into a conveyance deed or similar instrument (for example allotment letter). Even though the said notification does not deal with plots and is not applicable for joint development agreements entered post April 2019, the logic can be picked up, since the said notification deals with time of supply of similar services. Hence, the time of supply may be taken as when the developer enters into a conveyance deed or similar instrument to transfer possession in plots to the land owner, which may arise at the time of completion of the project. Hence, time of supply can be fixed at the time of completion of the project. This view also supports the valuation because, by the time the project gets completed, it is sure that any of the options namely open market value or cost of construction would be available to arrive at the tax liability.